## Internal Revenue Service

# memorandum

Br4:JTChalhoub

date: APR 12 1989

to: Thomas R. Ascher

Special Trial Attorney, Jacksonville SE: JAX

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject:

This is in reply to your request for technical advice concerning the subject taxpayer. This memorandum and attachments are for your use and are not to be distributed to other Service personnel (nor to the taxpayer) for their consideration.

### **ISSUE**

Should the Service execute a Form 872 consent for the taxpayer adds conditional language attempting to preserve the taxpayer's rights pursuant to I.R.C. § 6511(d)(2)(A) to timely claim a refund and litigate the merits of any Service recaptured tentative carryback allowance (from to to that is subsequently assessed and collected by the Service under I.R.C. § 6213(b)(3).

#### CONCLUSION

We see no reason for adding conditional language to a Form 872 for . We believe the Form 872 extension will operate to extend the time for filing a refund claim under I.R.C. § 6511(d)(2)(A) to 6 months after expiration of the period of limitation on assessments for \_\_\_\_\_, the source year of the carryback. The limitations period for filing a claim for refund is clearly stated to be either three years following the due date for the return of the source year of the carryback, or the period prescribed by I.R.C. § 6511(c), whichever period expires later. The claim limitation period prescribed by I.R.C. § 6511(c), as consented to by a taxpayer, is tied to the period of limitations on assessment; thus, any tolling of the statute of limitation on assessment also tolls the statute of limitation on claiming a refund under I.R.C. § 6511(c), and, consequently, under I.R.C. § 6511(d)(2)(A). See the attached copy of O.M. 19376 which discusses the tie-in.

To alleviate the concern of the taxpayer that the Service might refuse to extend the period of limitation on assessment for , and that the Service might wait until the last day of such period to recapture dollars in excessive allowances under I.R.C. § 6213(b)(3), we recommend you informally discuss

with the taxpayer its right to file protective claims for refund prior to the expiration of the period of limitations on assessment. The ground rules for such claims are discussed in the attached copy of G.C.M. 38786.

#### **FACTS**

The request for technical advice relates to the tax year in Docket No.

However, we were furnished with similar information that relates to the tax year which is before the Tax court in Docket No.

By notice of deficiency, dated the deficiency for the Service proposes a deficiency for the Service proposes a deficiency dated the deficiency for the Service proposes a deficiency for the Service proposes and the Service proposes a deficiency for the Service proposes and the Service proposes a deficiency for the Service proposes and t

With respect to page of the notice of deficiency advises that a tentative refund on Form 1139 was filed and granted to the taxpayer for the tax year ended and if a Tax Court petition is not filed for the Service will recapture an excess tentative allowance of \$ that was carried back from to to ...... Presumably the recapture of tax for would occur when an assessment is made for not later than 60 days after the 90th day if no Tax Court petition were filed. The deficiency in the notice would be assessed for under I.R.C. § 6213(c) and the recapture of the excess tentative allowance for would be summarily assessed under I.R.C. § 6213(b)(3) on the same day. Similarly, with respect to , page of the notice of deficiency advises that \$ of a total \$ tentatively allowed as a refund from the tax year ended , will be recaptured by summary assessment if a Tax Court petition is not filed for . Although each notice of deficiency refers to recapture of tentative allowances, neither notice separately proposed a deficiency for the respective carryback year, to nor to Nor, we are informed from transcripts, has the Service made any summary assessment for such carrybacks for and

The tax year has been tried and, we are informed that the Service will in all likelihood recommend an appeal be prosecuted in the event that an adverse Tax Court opinion is issued. A large tentative refund from was made that was carried back to the tentative refund was not disallowed in the notice of deficiency for the nor was it recaptured by summary assessment under I.R.C. § 6213(b)(3). Neither party before the Tax Court has pleaded the tentative refund and it is not an issue before the Tax Court.

The taxpayer is presently undergoing an examination of the loss year and the taxpayer is anticipating a proposed deficiency for that will be petitioned to the Tax Court. Both Appeals and the taxpayer believe a notice of deficiency will be issued for before the large tentative refund for from the large tentative refund for from However, if the Service elects to recapture the tentative allowance by summary assessment under I.R.C. § 6213(b)(3), the taxpayer is concerned that it might be prohibited from timely claiming a refund under I.R.C. § 6511(d)(2)(A). Their concern, as expressed to Appeals results from several cases decided by the circuits which ruled that the statute had expired for claiming a refund and that the two year payment rule does not apply. According to Appeals memo,

[T]he IRS can assess a tax for to the extent of the tentative refund, while the period of limitations is only open under Code Section 6503. Petitioner will not be able to file a timely claim for refund if the assessment and payment is made during the suspension period for under Code Section 6503.

The taxpayer, has submitted a modified Form 872 for consideration and Appeals has redrafted its own modified Form 872, substantially the same, to provide an agreement that Appeals believes will protect from being barred to claim a refund after the first the anticipated expiration date to file a claim for refund with respect to any recaptured tentative allowance for from from the first tentative allowance for from from from the first tentative and tentative and the first tentative and tentative and the first tentative and the first tentative and t

#### DISCUSSION

Section 6501(c)(4) of the Code provides generally that before expiration of the time for assessment, the Secretary and the taxpayer may execute a consent in writing which allows assessment to be made at any time before an agreed upon date. Further consents may be executed to extend the time for assessment if consented to before expiration of an earlier consent.

Section 6501(h) of the Code provides generally that if there is a deficiency attributable to a net operating or capital loss carryback, including any assessment under I.R.C. § 6213(b)(3), the deficiency may be assessed at any time before expiration of the period within which a deficiency may be determined for the loss year or source year for the carryback.

Section 6503(a)(1) of the Code provides, in relevant part, as follows:

The running of the period of limitations provided in section 6501 \*\*\* on the making of assessments \*\*\* in respect of any deficiency as defined in section 6211 \*\*\*, shall (after the mailing of a notice under section 6212(a)) be suspended for the period during which the Secretary is prohibited from making the assessment \*\*\* (and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Tax Court until the decision of the Tax Court becomes final), and for 60 days thereafter.

Section 6511(a) of the Code provides generally that a claim for credit or refund of an overpayment of tax must be filed by the taxpayer within 3 years from the time the return was filed or 2 years from the time the tax was paid, whichever expires later.

Section 6511(c) provides a special rule for claiming a refund that operates in lieu of section 6511(a). Under that rule, if the taxpayer consents to extend the statute of limitations on assessment, the taxpayer is provided 6 months after expiration of the assessment period within which to file a timely claim for refund. Section 6511(c) operates even when the assessment expiration date is suspended under section 6503(a)(1) until a decision of the Tax Court is final.

Section 6511(d)(2)(A) provides a special limitation period for filing a timely refund claim to recover tax in the case of a net operating loss or capital loss carryback. In lieu of the 3-year period prescribed in section 6511(a), the period of limitation for claiming a refund is that period which ends 3 years after the time prescribed by law for filing the return (including extensions thereof) for the taxable year of the loss, or the period prescribed under section 6511(c), whichever expires later.

Revenue Ruling 65-281, 1965-2 C.B. 444, provides guidelines in two separate situations on the timeliness of a claim for refund involving a net operating loss carryback. Under one situation, a claim is held invalid where the carryback year has been litigated and a final decision has been entered by the Tax Court, but the carryback year is still open under an I.R.C. § 6501(c)(4) agreement. In that situation, the claim filed after the period prescribed by I.R.C. § 6511(d)(2)(A) is held to be untimely even though the carryback year is still open. Under the second situation, where the carryback year was not litigated, a claim is not barred for that year for any other reason, and the carryback year is open under an I.R.C. § 6501(c)(4) agreement.

The ruling concludes that an I.R.C. §6511(d)(2)(A) claim with respect to a net operating loss carryback filed after the period prescribed therein but within two years from the time the tax was paid, or within the period agreed upon in the extension, would be valid and refundable.

In light of Rev. Rul. 65-281 and in the absence of a final Tax Court decision with respect to the carryback year, the 2-year payment rule will apply to any recaptured tentative allowance which has been assessed and paid when the claim is filed. Thus, if an appeal is taken with respect to the tax year from whatever decision is entered by the Tax Court, will have sufficient opportunity to timely claim refund of an assessment (and payment) under I.R.C. § 6213(b)(3) for that is recaptured while the tax year is on appeal. See and compare Rev. Rul. 88-88, 1988-41 I.R.B. 10 (October 11, 1988). However, if an appeal for the tax year is not taken, has every right to be concerned that its claim would be time barred if summary assessment takes place after

Appeals memorandum, dated November 30, 1988, refers to the case of Mar Monte Corp. v. United States, 503 F.2d 254 (9th Cir. In Mar Monte, for the tax year ended November 30, 1959, the taxpayer reported only capital gains and no ordinary income was subject to tax. Net operating losses were sustained in the next three fiscal years that could not be carried back to 1959 because no ordinary income was reported for that year. By notice of deficiency, the Service determined ordinary income should have been reported and the deficiency was petitioned to the Tax Court. A stipulated decision for \$10,606.00 became final on June 8, 1966. Mar Monte subsequently claimed a refund which was denied by the Service after paying the deficiency for 1959. In a suit for refund the district court ruled the period of limitations under I.R.C. § 6511(d)(2)(A) had expired, even though a claim for refund was filed within two years (actually a few months) from the time the tax was paid.

On appeal, the Ninth Circuit affirmed, holding that the two year payment rule is not applicable to a claim for refund, where the taxpayer's claim is made under I.R.C. § 6511(d)(2)(B) to lift the bar of res judicata to claim a carryback. The statute under paragraph (B) specifically refers to the period of limitations under paragraph (A) and that period had expired with respect to TYE November 30, 1959. The Ninth Circuit affirmance approves similar conclusions reached in both Brad Foote Gear Works, Inc. v. United States, 288 F.2d 894 (Ct. Cl. 1961) and Rev. Rul. 65-281. It is important to note that Mar Monte discussed the harshness of the position and concluded that Congress was very specific in treating previous Tax Court petitioners differently from other taxpayers, but that it had clearly done so in the

statute. The position of the Ninth Circuit in Mar Monte was also adopted with approval in Family Group. Inc. v. United States, 416 F. Supp. 1170 (E.D.N.Y 1976). Again, the comment is made that the result "does not comport with the common notion of equity" (503 F.2d at p, 258). In Family Group, the court said:

One effect of the statutory scheme is to demand special foresight and vigilance of a taxpayer who chooses the Tax Court as a forum, lest by inadvertence he lose the rights granted to him elsewhere in the Code.

In Longiotti v. United States, 819 F.2d 65 (4th Cir. 1987) we have yet another case of a taxpayer with a prior decision of the Tax Court being subjected to the harsh rule of I.R.C. § 6511(d)(2)(A). In late 1975, the Commissioner issued a notice of deficiency with respect to the tax year 1972. That notice was petitioned to the Tax Court and no pleading was made by the taxpayer that he was entitled to any net operating loss carryback for 1972 from losses sustained in 1973 and 1974. In October 1979 the parties settled the deficiency for 1972 and entered a stipulated decision on January 3, 1980 for \$187,120.22. deficiency was not paid until November 30, 1982. On October 3, 1984, the taxpayer filed a claim for refund of the paid deficiency on the ground of net operating loss carryback from 1973 and 1974 to 1972. The district court ruled that taxpayer's claim was barred by the statute of limitations in I.R.C. § 6511(d)(2)(A). The Fourth Circuit affirmed.

Where the taxpayer has not petitioned the Tax Court with respect to a carryback year, the Service position, as stated in Rev. Rul. 65-281, is that a two-year from payment rule is available to claim refund of a summarily assessed excess tentative allowance or to merely claim an overpayment on account of a net operating loss carryback. In Nelson v. United States, 757 F.2d 1537 (5th Cir. 1985), however, the taxpayer was allowed to recover only \$1,000.00 paid as a deficiency for 1974. He filed a claim for refund of more than \$55,000.00 based upon a net operating loss carryback from 1977 to 1974. The \$1,000.00 was paid on June 1, 1981 and the claim was filed on June 5, 1981. With respect to the tax paid on the original 1974 return, the Court held the claim for \$54,000.00 was time barred because it was brought later than the 15th day of the 40th month following the end of the taxable year of the loss. The taxpayer had filed his return for 1977 before June 15, 1978 after receiving an extension of time to file. Under the present statute, the claim would have been timely because extensions of time to file may be considered in computing the period of limitation.

We are acutely aware that is in a position which demands "special foresight and vigilance" lest the taxpayer by inadvertence lose rights granted to it elsewhere in the Code. However barsh the rule in I.P.C. § 6511(d)(2)(A) may be, the taxpayer is not without a remedy to guard against a time bar under that Code section.

Section 6511(a) provides a general rule with respect to the period within which a claim for refund may be filed. 6511(d)(2) provides a special rule with respect to net operating loss carrybacks. Where a consent has been executed (Form 872 or Form 872-A) for the loss year, section 6511(c)(1) provides that the statute of limitation on refunds shall expire six months after the expiration of the period within which an assessment may be made pursuant to the consent or agreement under section 6501(c)(4). Here the Service would have an additional period of time to recapture by assessment any excess tentative allowance from until expiration of a consent for . If petitioned to the Tax Court, section 6503(a)(1) would suspend the time for assessment of a deficiency for until the decision of the Tax Court became final, plus 60 days, plus any time "tacked" on that remained under the consent at the time a notice of deficiency was issued for of deficiency was issued for

At the time a notice of deficiency is issued for ............ the Service should summarily assess under I.R.C. § 6213(b)(3) the carryback determined to be excessively allowed from had not been previously petitioned to the Tax Court, the Service would have had three options available to recapture a tentative refund: 1) issue a notice of deficiency for the excess carryback (and any other adjustments) 2) make a summary assessment with respect to the excess carry back; or 3) file a suit under I.R.C. § 7405 for erroneous refund. Midland Mortgage Co. y. Commissioner, 73 T.C. 902 (1980). Only the latter two options remain available at the present time, and we believe that a suit for erroneous refund is not a viable option unless the Commissioner is prepared to assume the burden of proof. Neither is that option viable if the tentative allowance was made more than two years prior to filing suit under I.R.C. § 7405. I.R.C. § 6532(b).

is concerned that the Commissioner might decline to execute a consent to extend the period for assessment and the taxpayer would then be faced with expiration of the claim limitation period. However, your attention is called to a Seventh Circuit opinion involving the mitigation provisions and equitable recoupment. In O'Brien v. United States, 766 F.2d 1038 (7th Cir. 1985), an individual was held not to qualify for relief under the mitigation provisions or under the doctrine of equitable recoupment where a disputed low value for closely held

stock was used for computing the gain on the liquidation of the corporation. A higher stock price was subsequently determined by the Service in the estate tax matter which was not resolved until after the normal limitations period for claiming a refund had expired with respect to income taxation of the gain. In its O'Brien opinion, the Seventh Circuit discussed, in footnote 3, the remedies available to a taxpayer who might feel insecure about the refund limitation statute:

The government suggests that the taxpayer could have avoided his predicament by filing either a protective refund claim or a request for an extension of the statute of limitations for refund claims \*\*\*. Fourth Circuit in Chertkof v. United States, 676 F.2d 984 (4th Cir. 1982), indicated that to expect a taxpayer to file a protective claim involving 'unnecessary and obtrusive paperwork,' id. at 991 would unreasonably require the taxpayer to be 'hypercautious'. Id. But the government's suggestion regarding the request for an extension of the limitations period would not appear to place an onerous burden on the taxpayer. Apparently, such an extension can be obtained by requesting and completing an internal IRS document, a Form 872, available from the IRS agent involved in the relevant deficiency proceeding. The existence of pending litigation which would affect the taxpayer's refund claim of itself would justify the extension of the refund suit limitations period. Counsel for the United States assured us at oral argument that the extension would be routinely granted in cases such as the present one. The authority for the extension derives from 26 U.S.C. § 6511(c), which allows an extension of the period for filing a refund claim to six months after the time of expiration of an agreement, executed pursuant to 26 U.S.C. § 6501(c)(4), to extend the limitations period for assessment of a tax.

Additionally, it has been held that a general notice advising the government that the taxpayer believes his taxes have been erroneously assessed, requesting a refund and indicating that the basis of the refund claim is in litigation, is sufficient to constitute

an 'informal' refund claim which may be perfected by the filing of a formal refund claim after the refund claim limitations period has expired. [Citations omitted.]

In our view, footnote 3 in the O'Brien case covers both remedies that are available to in the present situation. First, should unilaterally submit a Form 872 or Form 872-A to the Service (unrestricted of course) for the tax year the Service has nothing to lose by extending the assessment period for that year. Secondly, whether or not as an alternative, there is nothing to prohibit a taxpayer from exercising a right to file a protective claim for refund at any time. All that is required of a refund claim as a predicate for filing suit, is that it put the Commissioner on notice of the ground of the taxpayer's claim that its taxes have been erroneously assessed for failure to allow a proper net operating loss deduction. National Force & Ordinance Co. v. United States, 151 F. Supp. 937 (Ct. Cl. 1957).

If you have any further questions, please contact Joseph T. Chalhoub at FTS 566-3345.

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Attachments:

Copy of O.M. 19376 Copy of G.C.M. 38786